IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

INCOME TAX REFERENCE No 156 of 1983

For Approval and Signature:

Hon'ble MR.JUSTICE R.K.ABICHANDANI and
MR.JUSTICE R.BALIA.

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1. Whether Reporters of Local Papers may be allowed to see the judgements?

2. To be referred to the Reporter or not?

3. Whether Their Lordships wish to see the fair copy of the judgement?

4. Whether this case involves a substantial question of law as to the interpretation of the Constitution of India, 1950 of any Order made thereunder?

5. Whether it is to be circulated to the Civil Judge?

COMMISSIONER OF INCOME TAX

Versus

PRECISE PLASTIC INDUSTRIES

Appearance:
Mr.Bharat J. Shelat, instructed by
MR MANISH R BHATT for the applicant.
SERVED for the Respondent.

CORAM : MR.JUSTICE R.K.ABICHANDANI and
MR.JUSTICE R.BALIA.

Date of decision: 30/01/97

ORAL JUDGEMENT : (Per R. Balia, J.)

On the direction of this Court under Section 256(2) of the Income Tax Act, 1961 at the instance of Revenue, following two questions have been referred to the opinion of the High Court arising out of Tribunal's

appellate order in the case of assessee dated 27.4.1981 concerning the assessment year 1977-'78 :-

1. " Whether, on the facts and circumstances of the case, the Income-tax Appellate Tribunal was right in law in cancelling the order of the commissioner of Income Tax made under sec. 263 of the Income Tax Act, 1961? "

2. " Whether, the conclusion of the Appellate Tribunal in holding that the order of the Commissioner of Income Tax suffered from a basic infirmity and was liable to be cancelled in respect of advances made by the assessee to the firm M/s. Shree Krishna Cast Iron & Brass Works and the interest income derived therefrom is correct in law and sustainable from the material on record?"

So far as the first question is concerned, it appears to be directed against the exercise of jurisdiction under Section 263 of the Income Tax, 1961 by the Commissioner of Income Tax on finding that the assessment for the assessment year 1977-'78 to be erroneous and prejudicial to the interest of Revenue and to be without jurisdiction. The Tribunal has observed that the Commissioner of Income Tax cannot make an order under Section 263 of the Income Tax Act merely on the ground that he thinks that a further inquiry is necessary or useful in relation to any issue decided by the Income Tax Officer in the regular assessment. To be able to make an order under Section 263 of the Income Tax Act, the Commissioner of Income Tax must have material on record at the relevant time, which leads him to the conclusion that the order of the Income Tax Officer is erroneous. As the Commissioner of Income Tax clearly appears to be in doubt regarding the relevant facts in this case and the conclusion of the Income Tax Officer in the matter, the Tribunal held that in making the aforesaid order under Section 263 of the Income Tax Act, the Commissioner of Income Tax has clearly stepped beyond the jurisdiction conferred on him under the provisions in so far as such order relates to the advance made by the assessee to Messrs. Shree Krishna Cast Iron & Brass Works and the treatment of the interest income derived therefrom.

So far as considering the contours of jurisdiction underlying Section 263 is concerned, we are in agreement with the Tribunal that jurisdiction under Section 263 cannot be invoked merely for the purpose of making a roving inquiry to find some error in the order of the Income Tax Officer, but it must be related to the findings, which must pre-exist before invoking jurisdiction, viz., that the order of the Income Tax Officer is erroneous in some respects and on account of that error, the order is prejudicial to the interest of revenue. If that finding is sustainable on material, then the fact that such error has crept in on account of not holding a proper inquiry is a relevant consideration and for that, necessary directions can be issued for holding an inquiry to arrive at a correct decision. However, so far as the present case is concerned, as per the Tribunal's own finding, the order of the Assessing Authority about inclusion of Rs.20,053/- advanced to Messrs. Scientific Mechanic Works was accepted to be erroneous and prejudicial to the interest of Revenue so as to warrant invoking jurisdiction under Section 263. It cannot be held that the order under Section 263, initiating proceedings of revision as such was without jurisdiction. If proceedings under Section 263 has come to be initiated on more than one ground and some of them satisfy the test for invoking the jurisdiction under Section 263, the fact that in respect of part of it, jurisdiction under Section 263 could not be invoked, cannot be a ground for holding that the initiation of proceeding itself was invalid from the beginning. This controversy can affect the order of the Commissioner on merits in respect of certain matters, which do not satisfy the two tests, on the basis of which the I.T.O's order can be interfered with. We, therefore, in view of the findings arrived at by the Tribunal in this case, in the context of inherent jurisdiction of the Commissioner to initiate proceeding under Section 263, hold that initiation of proceedings by the Commissioner could not have been held bad in its entirety.

However, the question still remains whether he had material to assume jurisdiction to issue notice in respect of particular assumed error and issue direction in that regard to hold an enquiry and find the existence of error is different mater. Since the merit of that issue and directions issued by the Commissioner in respect of advances made to Messrs. Shree Krishna Cast Iron & Brass Works is directly part of question No.2, we shall deal with that aspect with reference to question No.2.

Regarding the sum advanced to Messrs. Shree Krishna Cast Iron & Brass Works, the Commissioner's order for directing an enquiry to be held and to be excluded from computation of capital employed is founded on the reasoning in the words of the Commissioner himself :-

> "... It appeared that these amounts had not been utilised in any manufacturing activity and in view of Rules 19(A)(4) of the I.T. Rules, 1962, these amounts were not includible in computing the capital employed in the industrial undertaking in respect of the profits of which deduction u/s. 80-J was allowed by the Income Tax Officer...."

The relevant facts, which have been noticed by the Commissioner in respect of this advance, are that the gross total income for the assessment year in question included interest, amounting to Rs.49,896/- from these loans. The net balance in the account of Messrs. Shree Krishna Cast Iron & Brass Works at the beginning of the previous year relevant to assessment year 1977-'78 was Rs.5,24,197/-. The assessee's explanation, in clear terms, was that the said firm, which is its main purchaser, would not be able to purchase its goods unless they have sufficient finance to sell goods on credit for a long duration. If the amount is not advanced by it, it would not have been possible for it to purchase goods from the assessee and the assessee would not have been able to sell its goods so quickly and easily. It, therefore, urged that the advances to the said firm is in the course of ordinary business and not an investment of money or pure and simple sharafi advances. In the like manner, it was also urged before the Commissioner that if the payments received by cheques were credited in advance account, instead of sales accounts of the parties, there would not have been debit balance in the advance account and the outstanding balance on account of annual unrealised sales, i.e. to say, if the amounts received and credited to sales account are credited to the advance account, then there will be like amount outstanding on the sales on credit. We find from the order of the Commissioner that no attempt has been made to examine this contention of the assessee from the material available on record to even arrive at a prima facie conclusion that the explanation is not acceptable or is contentious. Without finding this exclusion to be erroneous on some material before it, even prima facie,

the Commissioner could not have proceeded straightway to order an inquiry and leave it to be found out by the assessing authority whether there was any error in computation or not.

Moreover, if we look at the scheme of Rule 19A, which is the rule prescribed for the purpose of computing the capital employed for the purposes of Section 80J, we find that the order of the Commissioner also ignores the same. Relevant part of Rule 19A, during the relevant assessment year, read as under :-

" 19A. Computation of capital employed in an industrial undertaking or a ship or the business of a hotel for the purposes of section 80J.-(1) For the purposes of section 80J, the capital employed in an industrial undertaking or the business of a hotel shall be computed in accordance with sub-rules (2) to (4), and the capital employed in a ship shall be computed in accordance with sub-rule (5).

(2) The aggregate of the amounts representing the values of the assets as on the first day of the computation period, of the undertaking or of the business of the hotel to which the said section 80J applies shall first be ascertained in the following manner :-

(i) in the case of assets entitled to depreciation, their written down value;

(ii) in the case of assets acquired by purchase and not entitled to depreciation, their actual cost to the assessee;

(iii) in the case of assets acquired otherwise than by purchase and not entitled to depreciation, the value of the assets when they became assets of the business;

(iv) in the case of assets being debts due to the person carrying on the business, the nominal amount of those debts;

(v) in the case of assets being cash in hand or bank, the amount thereof.

Explanation 1.- xxx xxx xxx

Explanation 2.-xxx xxx xxx

Explanation 3.- xxx xxx xxx

(3) From the aggregate of the amounts as ascertained under sub-rule (2) shall be deducted the aggregate of the amounts, as on the first day of the computation period of borrowed moneys and debts owed by the assessee (including amounts due towards any liability in respect of tax).

Explanation.- xxx xxx xxx

(4) The resultant sum as determined under sub-rule (3) shall be diminished by the value, as ascertained under sub-rule (2), of any investments the income from which is not taken into account in computing the profits of the business and any moneys not required for the purpose of the business, in so far as the aggregate of such investments or moneys exceed the amount of the borrowed moneys which under sub-rule (3) are required to be deducted in computing the capital.

(5) xxx xxx xxx ...."

A close reading of the aforesaid provision lays down three steps for arriving at the capital employed by an assessee claiming deduction under Section 80J of the Act. The first step is to aggregate the amounts representing the values of the assets as on the first day of the computing period of the undertaking to which Section 80J applies. The assets, whose values are to be aggregated, include under sub-clause (iv) of sub-rule (2) assets being debts due to the person carrying on the business, the nominal amount of those debts. Therefore, in the first step of computing capital employed, the debts due to the assessee shown in the books of account have to be included. The second step is to reduce the aggregate values of assets as determined under sub-rule (2) by the borrowed moneys and debts owed by the assessee as on the

first day of computation period. Sub-rule (4), on which reliance has been placed by the learned Commissioner, embodies third step, i.e. to say, the sum total of the capital employed arrived at after adjusting the debts due on the first day against the value of assets determined under sub-rule (2), is to be further diminished by the value of any investment, which satisfies two conditions. Firstly, before the investments could be deducted from the balance of capital employed left after making adjustments as per sub-rules (2) and (3), first condition is that income from such investment should not be taken into account in computing the profits of the business and the second condition is that any moneys not required for the purposes of the business in so far as aggregate of such investment or moneys exceed the amount of borrowed moneys, which under sub-rule(3) are required to be deducted in computing the capital. These conditions clearly envisage that only those investments to the extent they exceed the total borrowed capital, which has already been reduced from the total value of assets, including debts outstanding on the first day of the previous year concerned, are to be considered for diminishing the extent of capital employed. To the extent the investment made, even if they are not required for the purpose of business, do not exceed the total amount of the borrowed moneys already deducted from the total value of assets, cannot be taken out of consideration.

Considering the order of the Commissioner in the light of the aforesaid provisions of sub-rule (4), we find that so far as the first condition is concerned, income from the investment sought to be included, and should not be taken into account for computing the profits of business, does not exist in the present case. As per the order under Section 263 itself, the interest earned on the investments in question had been taken into consideration while computing the profits of the business for that year. So far as the second condition is concerned, the Commissioner has not at all applied his mind to the material on record. It does not say anywhere that the investments, which are directed to be excluded from the computation of capital employed and are not required for the purposes of business, are in excess of the aggregate of borrowed moneys, which have been reduced from the value of assets determined under sub-rule (2). In the absence of these two findings, which are a sine qua non for excluding investment, the Commissioner could not have arrived at any decision about the erroneous nature of computation and its prejudicial nature to the interest of Revenue. Therefore, in our opinion, the

orders simply amounted to making a roving inquiry to recompute the capital employed without even prima facie finding on the basis of material which was before it that the computation of capital employed in terms of Rule 19A was erroneous. In that view of the matter, in our opinion, the Tribunal was right in not confirming the order of the Commissioner in respect of the advances made by the assessee to firm Messrs. Shree Krishna Cast Iron & Brass Works and interest income derived therefrom.

Accordingly, we answer question No.2 in affirmative, i.e. to say, against the Revenue and in favour of the Assessee. No order as to costs.

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(apj)